NIK SHARIFUDDIN BIN NIK KADIR

v.

MOHAIYANI SECURITIES SDN. BHD.

HIGH COURT MALAYA, KUALA LUMPUR
DATO' DR. ZAKARIA BIN MOHD YATIM J.
[ORIGINATING SUMMONS NO. D4-24-29 OF 1993]
29 JUNE 1994

GUARANTEES & INDEMNITIES: Plaintiff dealing as remisier with defendant under an agreement dated 14 May 1992 - Plaintiff providing defendant with bank guarantee to guarantee the due performance of his obligations under the agreement - Defendant attempting to call in bank guarantee - Plaintiff applying for an injunction to restrain defendant - Whether the bank guarantee was an unconditional guarantee - Whether there are serious questions to be tried - Whether the balance of convenience in favour of plaintiff or defendant.

The plaintiff commenced dealings as a remisier with the defendant under a remisier agreement dated 14 May 1992. It was *inter alia* a term of the agreement that the plaintiff was to provide a security sum of RM50,000 to be used to guarantee the due performance by him of the obligations and covenants under the agreement. The plaintiff provided a bank guarantee for the sum of RM50,000 which was accepted by the defendant.

During the course of his dealing the plaintiff purchase 44,000 shares of Sanda Plastics Industries Bhd. on the instructions of his client. Before the time limited for settlement of the purchase price, under the terms of trading of shares on the KLSE, the defendant sold the said shares without the plaintiff's or his client's knowledge or consent. The defendant then informed the plaintiff that there was a deficit in his account and attempted to call on the bankers guarantee.

The plaintiff applied for an injunction to restrain the defendant from calling in the guarantee.

Held:

[1] The bankers guarantee is a form of security. The defendant accepted the bankers guarantee in lieu of cash deposit of RM50,000 and the defendant by their letter dated 18 February 1992 stated that the bankers guarantee was required as collateral. In the circumstances the bankers guarantee is not an unconditional guarantee and the Court should look at the terms of the underlying contract.

[2] The allegations raised by the plaintiff and the counter-allegations made by the defendant had raised serious questions to be tried regarding the conduct of the defendant under the terms of the agreement. Until these questions are decided at the trial, the defendant should be restrained from calling on the guarantee. The balance of convenience is in favour of the plaintiff.

[Order in terms of plaintiff's application. Costs in the cause].

Cases referred to:

Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. [1978] 1 All ER 976 ***(refd)***
Syarikat Perumahan Pegawai Kerajaan Sdn. Bhd. v. Bank Bumiputra Malaysia Bhd. [1990] 2 CLJ 1052/[1991] 2 MLJ 565 ***(refd)***
Kirames Sdn. Bhd. v. FELDA [1991] 2 CLJ 1366/[1991] 2 MLJ 198 ***(refd)***
IE Contractors v. Llyod's Bank plc 51 BLR 5 ***(refd)***

Royal Design Studio Pt. Ltd. v. Chang Development Pte. Ltd. [1991] 2 MLJ 229 ***(refd)***
Hortico (Australia) Pty. Ltd. v. Energy Equipment [1985] 1 NSWLR 545 ***(refd)***
Premier Tryes Ltd. v. State Trading Corporation of India Ltd. [1981] 51 Comp. Ces. 316 ***(cit)***
Potton Homes Ltd. v Cloeman Contractors Ltd. 28 BLR 24 ***(refd)***
Barclay Mowlen Construction Ltd. v. Simon Engineering [1991] 23 NSWLR 451 ***(refd)***
Australasian Conference Association Ltd. v. Mainline Constructions Proprietary Ltd. (In Liquidation) & Others [1978] 141 CLR 335 ***(refd)***

Legislation referred to:
Securities Industries Act 1983

Other sources referred to:
Rowlatt on Principal and Surety, 3rd Edn., (1936), p. 4

For the respondent - Julian Ding; M/s. Zaid Ibrahim & Co.
For the defendant - June Khoo; M/s. Lainah Yow & Zur

JUDGMENT

Dr. Zakaria Bin Mohd Yatim J:
This is an application by the plaintiff for an order that the defendant be restrained from calling, demanding or encashing the bank guarantee issued by Perwira Habib Bank Malaysia Berhad (the Bank) dated 12 February 1992 (MS.B9/CTL/15/92).

The application was made *ex parte*. At the hearing of the application I ordered that it be heard *inter partes*, but I made an interim order in terms of prayer 1 of the application until the date of the *inter partes* hearing.

The plaintiff is a licenced dealer's representative under the Securities Industries Act, 1983. The defendant is a stock broking firm and is a member of the Kuala Lumpur Stock Exchange (KLSE) and carries on its business at 54, Jalan SS21/35, Damansara Utama, Petaling Jaya, Selangor.

The plaintiff commenced dealings as a remisier with the defendant after obtaining his licence. On 14 May 1992 he entered into a remisier agreement with the defendant. Clause 2(i) of the agreement provides that the plaintiff, upon the execution of the agreement would place with the defendant a sum of RM50,000 "which shall be used to guarantee the due performance by the remisier of the obligations and covenants under this agreement (hereinafter referred to as security sum')".

Before the agreement was entered into, the defendant, on 18 February 1992 wrote to the plaintiff informing him that he could commence trading as a remisier after the remisier agreement had been completed.

The letter also stated the condition requiring the plaintiff to place a minimum cash deposit of RM50,000 before trade, but the defendant would accept a banker guarantee for that amount instead of cash. Paragraphs 2 & 3 of the letter states as follows:

(1) A banker's guarantee of RM50,000 will be placed with the Company as collateral against your trading. Your personal outstanding balances in A/C N1050 will be taken into account when computing your daily trading limits. As a general rule, the trading limit is computed as eight times the total deposits after deducting contra losses.

(2) It is a condition of the Company, that remisiers place a minimum cash deposit of RM50,000 before trading. However, in your case, the Company will, in the

meantime, accept the **banker's guarantee for** RM50,000 instead until such time your contra losses have been fully paid. Thereafter, arrangements must be made to top up the cash deposit either through direct payment or through deductions from your commissions.

Earlier, on 12 February 1992, the Bank had in fact issued the banker's guarantee for RM50,000 in favour of the defendant. The banker's guarantee is reproduced below:

12 February 1992

Attn: En. Nik Sharifuddin
The Board of Directors
Mohaiyani Securities Sdn Bhd
No 54 Jalan SS21/35
Damansara Utama
47400 Petaling Jaya
Selangor Darul Ehsan

Dear Sirs

Bankers Guarantee

As requested by En. Nik Sharifuddin bin Nik A. Kadir Nric No. 4497861 of No 21 Jalan Setiabakti Bukit Damansara 50490 Kuala Lumpur, **we hereby guarantee that the sum of RM50,000 (Ringgit: Fifty Thousand Only) being the amount of security deposit required to be deposited with you.** This amount shall be paid by us upon demand.

This Guarantee is effective from 12 February 1992 until 11th Feb 1993.

All claims if any in respect of this guarantee shall be made during the validity of the guarantee or within 14 days from the expiry date of the said guarantee. If no claims is made on or before the aforesaid date then all our liabilities and obligations shall be absolved.

This guarantee must be returned to us for cancellation upon expiry.

for Perwira Habib Bank (M) Berhad

sgd	sgd
...	...
Mohamed Abdul Malek (1/035)	Faridah bt Mokhtar (1/404)
Branch Manager	Officer

[Emphasis Added]

On 7 January 1993 the defendant wrote to the plaintiff informing him that there was a deficit amounting to RM11,321.74 in the plaintiff's account. The plaintiff was asked to settle the amount by 14 January 1993 otherwise the defendant would call on the banker's guarantee. Subsequently the plaintiff was informed by the Bank that the defendant had taken steps to call on the banker's guarantee.

The plaintiff, in his affidavit (enclosure 3) in support of the application averred on 11 December 1992, that he was instructed by his client to purchase 44,000 shares of Sanda Plastics Industries Bhd (the said shares). The purchase price ranged from RM4.22 to RM4.28 per share. Under the terms of trading of shares on the KLSE, settlement of the purchase price by a buyer was to be made within seven trading days after the transaction, excluding Saturdays, Sundays and public holidays. He said that his client had until 21 December 1992 to settle the outstanding purchase price. He alleged that,

contrary to the KLSE terms of trading and settlement, the defendant, on 14 December 1992 sold the said shares without his or his client's knowledge or consent. On the same day, that is 14 December 1992 the defendant unilaterally varied the terms of the remisier agreement purporting to give themselves the unilateral right to sell without the consent of the plaintiff's client. The price of the said shares was at its highest at RM6.20 per share. If the defendant had not sold the said shares on 14 December 1992 the plaintiff's client would have earned a profit of approximately RM88,000. The said highest price was recorded at the KLSE within the period for settlement of the purchase price of the said shares. The plaintiff added that but for the defendant's actions, there would not be any sum outstanding to the defendant and therefore the right of the defendant to be indemnified would not arise. The plaintiff further said that the defendant had repudiated the agreement and was not entitled to call on the banker's guarantee.

Puan Muhaiyani in her affidavit affirmed on behalf of the defendant (enclosure 8) alleged that the plaintiff had wrongfully placed a purchase order for RM44,000 shares of the said shares. Under clause 4 of the agreement the defendant, on 16 July 1992 issued a circular to all remisiers on the new arrangements on contra losses and billings to clients. She averred that as a result of the plaintiff wrongfully placing the order on behalf of his client, the defendant, on 14 December 1992 issued a memorandum to all remisiers reminding them of the daily trading limits. She alleged that the plaintiff did not have any credit to support the purchase of the said shares. The plaintiff was terminated as a remisier on 14 January 1993. In paragraph 8 of the affidavit she said,

> ... Pursuant to clause 12 of the remisier's agreement ... the defendant seeks to exercise their right of indemnity by calling on the bank guarantee ... for the outstanding balance in the plaintiff's account...

At the *inter partes* hearing Mr. Julian Ding, Counsel for the plaintiff submitted that the banker's guarantee was a form of security given to the defendant. He said that the defendant had acted negligently by force selling the shares before the expiry of the seven days period. The price of the shares went up within the seven days. He contended that the defendant was negligent in not following the KLSE rules and therefore not entitled to claim the indemnity. He then referred to the cases. He submitted that the case of *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] 1 All ER 976 was wrongly decided. He said that the decisions of the High Court in *Syarikat Perumahan Pegawai Kerajaan Sdn. Bhd. v. Bank Bumiputra Malaysia Bhd.* [1991] 2 MLJ 565; and *Kirames Sdn. Bhd. v. FELDA* [1991] 2 MLJ 198 are only persuasive authorities. But later in his submission he said that *Kirames* case was correctly decided because the terms of the guarantee was very clear. He relied however, on *IE Contractors v. Llyod's Bank* plc 51 BLR 5; *Royal Design Studio Pt. Ltd. v. Chang Development Pte. Ltd.* [1991] 2 MLJ 229; *Hortico (Australia) Pty. Ltd. v. Energy Equipment* [1985] 1 NSWLR 545; *Barclay Mowlen v. Simon Engineering* [1991] 23 NSWLR 451.

Miss June Khoo, Counsel for the defendant reiterated Puan Muhaiyani's averment in her affidavit. Miss Khoo submitted that the purchase order was wrongly placed by the plaintiff. She said that the plaintiff could not claim liability under the remisier agreement. According to her, the defendant sold the shares and made a profit. She added that the question whether the defendant could force sell the shares at the earlier date is being considered in another Court. She then referred to the case law. She said that *IE Contractors* did not overrule *Edward Owen's* case. She said that the present case was

concerned with on demand guarantee. She referred to *Kirames* case at page 201. She also referred to a passage in the judgment of Indian High Court in New Delhi in *Premier Tryes Ltd. v. State Trading Corporation of India Ltd.* [1981] 51 Comp. Ces. 316 at pages 332 & 333.

It is now necessary for me to examine the cases cited by both Counsel which I consider relevant to the present application.

In *Edward Owen's* case, the performance bond was an unconditional guarantee payable by the bank on demand. The English Court of Appeal decided that the bank was under obligation to pay irrespective of whether or not the person whose performance was granted had in fact performed his obligations or was in default except in cases of fraud of which the guarantor had notice. In his judgment at page 981 Lord Denning MR said, "A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit..."

At page 983 Lord Denning said:

> All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A Bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not.
>
> The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.

In *IE Contractors,* Staughton LJ examined the similarities and differences between letters of credit and performance bonds when he discussed the doctrine of strict compliance. In his judgment at pages 9 & 10, Staughton LJ said:

> The second general principle said to be applicable to transactions of this kind is the doctrine of strict compliance. It is very well established for letters of credit: the documents presented must be precisely those which the letter of credit calls for ... We were not referred to any decision that the doctrine of strict compliance applies with equal force to performance bonds... I agree that there is less need for a doctrine of strict compliance in the case of performance bonds ... The degree of compliance required by a performance bond may be not so strict. It is a question of construction of the bond...

In that case the terms of the performance bonds issued to the second defendant were as follows:-

(1) We have issued in your favour, as beneficiaries, this letter of guarantee to indemnify you against any damages that you may sustain, up to an amount of I.D. 211,896 (Iraqi Dinars Two Hundred Eleven Thousand Eight Hundred and Ninety Six Only)

(2) Covering performance of contract guarantee covering damages which you claim are duly and properly owing to your organisation by GKN Contractors Ltd., under the terms of the contract for a slaughterhouse at Duhouk made on 12 June 1978.

between you and GKN Contractors Ltd. and Ross Poultry Ltd.

(3) We undertake to pay you, unconditionally, the said amount on demand, being your claim for damages brought about by the above named principal.

The demand made on all three bonds was as follows:

> In view of the non-discharge by the company of its contractual obligations in making good the deficiencies of the slaughter house of Al-Quadisiya, Rarbala and Dohuk, we request withdrawal of the under-mentioned guarantees and transference of their amounts to this establishment.

The Court of Appeal decided that the bonds were not to be interpreted as stating that the second defendant would pay if the precise words set out in Court were to be found in the demand. The demand stated in substance, although not in express words, that it claimed damages for breach of contract and that was therefore sufficient. Accordingly the second defendant was liable to the employer.

Staughton LJ in his judgment at page 9 said:

> I take this to show that there is a bias or presumption in favour of the construction which holds a performance bond to be conditioned upon documents rather than facts. But I would not hold the presumption to be irrebuttable, if the meaning is plain.
>
> The second possibility in the *Esal* case was adopted by Ackner LJ (with whom Glidewell LJ agreed), but not by Neill LJ. This was that the demand had to assert a breach of contract, a result which Ackner LJ described as "very salutary" (at page 550). I agree that this is a construction which one would wish to adopt, since it requires the beneficiary to state in plain terms that which he must, if honest be prepared to assert - and may place him in peril of a charge of obtaining money by deception if it is untrue to his knowledge. However, like Legatt J, I doubt whether it is sufficient reason to adopt a particular construction of a commercial contract that the result would be desirable or salutary.

The proposition laid down in *IE Contractors* case is found in the judgment of Sir Denys Buckley at page 15. It reads as follows:

> I am in entire agreement with the proposition that to discover what the parties intended should trigger the indemnity under the bond involves a straightforward exercise of construction, or interpretation, of the bond to discover the intention of the parties in that respect. In carrying out that exercise we must, no doubt, have regard to the terms of the bond as a whole, but it seems unlikely that we shall obtain much, if any, assistance in discovering what kind of demand is required to trigger the indemnity from paragraphs 4, 5 or 6. In fact, I think, they provide no assistance.

In *Potton Homes Ltd. v Cloeman Contractors Ltd.* 28 BLR 24, Eveleigh LJ, in his judgment at page 28, said: "as between buyer and seller the underlying contract cannot be disregarded so readily. If the seller has lawfully avoided the contract *prima facie*, it seems to me he should be entitled to restrain the buyer from making use of the performance bond." In *Barclay Mowlen Construction Ltd. v. Simon Engineering* [1991] 23 NSWLR 451 the Supreme Court of New South Wales, decided that a bond incorporating the terms of the building contract could only be called upon if the defendant became contractually entitled to exercise its rights under the contract in respect of the security and that had not assumed in that case.

In *Royal Design Studio Pte Ltd v. Chang Development Pte Ltd* [1991] 2 MLJ 229 the Singapore High Court decided:

> The Court, in determining the defendant's entitlement to call on the performance bond, is concerned with the relationship between the parties under the main or underlying contract they have made and the dispute arising from such relationship and not whether the bond is binding on the bank or insurance company that issued it. In such a case, there

a

> is no reason why the court should be inhibited from exercising its equitable jurisdiction and restraining the defendant from calling on the bond, if the facts warrant it, merely because the bond is like a letter of credit.

After considering the cases cited above, I must state at the outset that I disagree with Mr. Julian Ding's submission that *Edward Owen's* case was wrongly decided. In that case Lord Denning explained how he came to the conclusion that a performance b guarantee stood on a similar footing as a letter of credit. In my view this still hold true in cases of on demand guarantees, which was the issue before Lord Denning, as the guarantee he was construing was payable "on demand without proof of conditions."

In *Kirames* case, on a true construction of the terms of the security guarantee, it is clear that the guarantee was also an unconditional and on demand bond. Clause (a) of the c guarantee/bond states that the sum shall be paid by the guarantor forthwith on demand by the beneficiary in writing without the beneficiary having to assign any reason whatsoever for such demand; and clause (b) states that the sum shall be paid forthwith irrespective of whether or not there is any dispute between the said contractor and the beneficiary in respect of and relating to the said contract or in respect of any other matter and irrespective of whether or not such said dispute if any has been settled, resolved, d litigated an adjudicated upon otherwise howsoever. The words of the guarantee are very clear and unambiguous that it is intended to be unconditional and payable on demand in writing. In no way can the guarantee be read to incorporate the underlying contract as the obligation to pay is only dependent on receiving a written demand and not on any terms of the underlying contract. The case of *IE Contractors* was not cited by Counsel in *Kirames* case. Even if the principle laid down in *IE Contractors* had been applied, the e result would have been the same.

In the present case the banker's guarantee is a form of security.The guarantee document states that the Bank guaranteed that the amount stated therein being "the amount of security deposit required to be deposited" with the defendant. Clause 2(i) of the agreement provides that the plaintiff would place the sum of RM50,000 "which shall be used to guarantee the **due performance by the remisier of the obligations and** f **covenants under this agreement**..." [Emphasis added]. The defendant accepted the bankers guarantee in lieu of cash deposit of RM50,000. In the defendant's letter dated 18 February, 1992 it was stated that the banker's guarantee was required as collateral. In *Australasian Conference Association Ltd. v. Mainline Constructions Proprietary Ltd. (In Liquidation) & Others* [1978] 141 C.L.R. 335, Gibbs ACJ in his judgment at pages 347 & 348 said:

g

> The undertaking of the Bank was expressed to be given in consideration of the appellant dispensing with the provision of a retention fund, and was undoubtedly given for the purposes of cl. 30(c) of the building contract - it was a "bank guarantee, guarantee bond or other form of security" within the meaning of that clause. It was therefore intended to be "effective as security in lieu of the Retention Fund", i.e. effective as security that Mainline should carry out its obligations under the contract - see cl. 30(a). Although the h liability assumed by the Bank was in form absolute, it was, to the knowledge of the appellant, only undertaken for the purpose of affording security for the performance by Mainline of its obligations; the undertaking was collateral in substance, although not in form. The contract between the appellant and the Bank appears to fall within the description of "guarantee" contained in such authorities as **Rowlatt on Principal and Surety,** 3rd edn. (1936), p. 4; *Jowitt v. Callaghan* and *Re Conley*.

i

In the present case there is no evidence that a demand had been made on the guarantee, but in its letter dated 7 February 1993, the defendant had indicated that it would draw down on the banker's guarantee.

In my opinion, the banker's guarantee is not an unconditional guarantee. In the circumstances the Court should look at the underlying contract. Clause 6(ii) of the agreement provides that the plaintiff is to indemnify the defendant against all losses where a buying client has failed to pay within the time allowed by the Rules of the Exchange and where the defendant has to sell in the open market for the same securities and incurs a loss in doing so. Clause 11 provides for the termination of the agreement.

The plaintiff alleged that the defendant had repudiated the agreement and that the defendant had sold the said shares within the seven days period contrary to the KLSE rules. Mr. Julian Ding contended that there was a breach of the underlying contract in that the buying client did not have the opportunity to buy the shares and that the defendant sold the said shares without the consent of the buying clients. Mr. Julian Ding also alleged that there was a breach of contract by the defendant in not complying with the seven days KLSE Rules.

The defendant on the other hand alleged that the plaintiffs did not have any credit to support the purchase of the 44,000 shares. According to the defendant, the plaintiff was subsequently terminated as a remisier on 14 January 1993. Miss June Khoo submitted that the purchase order was wrongly placed by the plaintiff and he could not therefore claim liability under the agreement.

I find that there are serious questions to be tried regarding the conduct of the defendant under the terms of the agreement. Until these questions are decided at the trial, the defendants should be restrained from calling on the banker's guarantee.

The balance of convenience is in favour of the plaintiff.

For the reasons stated above, I made an order in terms of the application. Costs in the cause.